Swatch Group Ltd. - A Way To Success

Presenting to Nick Hayek, CEO Swatch Group Ltd.

Project Team
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“Is the Apple watch killing the Swiss watch industry?”

Key challenges

- Compete with Apple
- Turnaround in revenue and profit
Cooperation and M&A are way to success

**Analysis**
- Growing smart watch segment but still connected with uncertainty
- Consolidation in market for mechanical watches

**Actions**
- Cooperate with Garmin and Google for smartwatches in sports segment
- M&A strategy in market for mechanical watches

**Result**
- Diversified revenue portfolio
- Back on revenue and profit growth track
Current development shows need to react

Development of Sales & Net Income

<table>
<thead>
<tr>
<th>Year</th>
<th>Change in sales</th>
<th>Change in Net income</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>20.00%</td>
<td>20.00%</td>
</tr>
<tr>
<td>2013</td>
<td>10.00%</td>
<td>10.00%</td>
</tr>
<tr>
<td>2014</td>
<td>0.00%</td>
<td>-10.00%</td>
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<tr>
<td>2015</td>
<td>-20.00%</td>
<td>-30.00%</td>
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</table>
Consolidation is great opportunity for growth through M&A

**Analysis**

**Key success factor**

**Profit from market consolidation**

- **Consolidation trend** in mechanical watch market → look for interesting targets to buy
- Watches are bought because of **emotionality** → focus on core values like timelessness and craftsmanship
- 85% of customers of luxury watches do not see Apple Smartwatch as a **substitute** → low game breaking risk
Smart watch market is worth to be analyzed

Predicted market growth for smartwatches & wearables
Deep dive smart watches: Partners are necessary to succeed in the market

- Market is in the **early adopter phase** → growing market with potential
- **Connectivity to smartphones** is needed → look for potential partners to get access
- Lot’s of **uncertainty** due to growth rates and future development → do not solely focus on it

**Key success factor**

- **Get access to smartphone technologies**
- **Focus on niche markets**
Internal Strengths: Core values and expertise are key to success

- Great know how (mechanical watches)
  - High quality
  - Long lasting
  - Efficient production
  - Innovativeness and patents
- Core values: **timelessness and craftsmanship**
- Great position in **luxury segment** (95 % of the profit are gained due to luxury watches)
Internal Fields for improvement: Look for partners to access smart watch market

- limited access to smartphone technologies $\Rightarrow$ look for potential partners
- Currency dependency (Swiss franc) $\Rightarrow$ diversify portfolio
- Decreasing sales and decreasing net income (stagnation) $\Rightarrow$ diversify portfolio
Key takeaways from analysis on a glance

- Profit from market consolidation
- Use expertise in high quality and efficient production
- Diversify portfolio geographically
- Get access to smartphone technologies
- Focus on niche markets
- Focus on core values: timelessness and craftsmanship
## Decision time (mechanical market): focus on what you can do best

<table>
<thead>
<tr>
<th></th>
<th>Focus on luxury market (M&amp;A)</th>
<th>Focus on mass market (M&amp;A)</th>
<th>Divestment</th>
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<tbody>
<tr>
<td>Strategic fit</td>
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<td><img src="https://via.placeholder.com/15" alt="Red" /></td>
<td><img src="https://via.placeholder.com/15" alt="Red" /></td>
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<tr>
<td>Fit to key success factors</td>
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<td><img src="https://via.placeholder.com/15" alt="Yellow" /></td>
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<td>Feasibility</td>
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<td><img src="https://via.placeholder.com/15" alt="Green" /></td>
<td><img src="https://via.placeholder.com/15" alt="Yellow" /></td>
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</tbody>
</table>

Core values and great know how in mechanical watches are deal breakers for divestment
Decision time (smartwatch market): Collaborate to be successful

<table>
<thead>
<tr>
<th></th>
<th>Self-made</th>
<th>Collaboration</th>
<th>Exit</th>
</tr>
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<tr>
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<tr>
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</tr>
<tr>
<td>Feasibility</td>
<td><img src="red" alt="Red" /></td>
<td><img src="green" alt="Green" /></td>
<td><img src="green" alt="Green" /></td>
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</tbody>
</table>

Limited access to smartphone connectivity as deal breaker for self made strategy

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Strategy is based on two pillars

Future Strategy

Smart watches
- Joint Venture with Garmin
- Focus on the sport segment

Mechanical watches
- Market expansion through M&A
- Core Value awareness

Implementation
Sports market is a lucrative niche to enter smart watch market

Get access to smartphone technologies

Smart watches

- Through Joint Venture with Garmin: expansion of the expertise in the sports segment
  - No stuck in the middle: clear choice of the segment
  - Clear Unique Selling Proposition
  - Usable in every sports
- Focus on what Swatch stands for: robust, Swiss made & designed, for everyone and with a life long guaranty
- Long battery & changeable bracelets
- Cooperation with Google for connectivity with smartphones
Deep Dive Skiing: A new sports device is born

Focus on niche markets

Smart watches

• As an example: the skiing sport segment
• Lara Gut (the famous skier of Switzerland) as the marketing ambassador worldwide
• Special bracelet edition, promotion video shows her and the functions of the watch while skiing
  ➢ Possible same-time tracking as an improvement option for the trainer in training
  ➢ Connection with mobile, laptop, health devices
• Marketing cooperation with Stoeckli Ski: the Swiss made Skis
  ➢ New customer groups through cross selling potential
Acquire brands that fit your key success factors

- M&A of watch companies who fit into our values and strategy (luxury segment)
  - Timelessness & craftsmanship: Junghanns & Nomos Glashuette
- External analysis proofed the importance of profit from market consolidation
- Swatch will diversify the portfolio geographically through M&A
Use own expertise for PMI

M&A process

Targets
Junghanns and Nomos

Resources

• Use cashflow from operating activities (around 1 billion CHF per year)
• Exploit low interest rate environment and strong equity ratio for new debt if necessary

Buying process

• Engage investment banks
• Try to fully own the companies and avoid partnerships

Post Merger Integration

• Leave companies as they are & don’t change brand image
• Try to hold existing Mgmt.
• **Reason:** Companies already fit to expertise/values of Swatch
• Try to achieve synergies in administration & procurement

Use expertise in high quality and efficient production
Smart Watch divisions generates new value for the Swatch Group

<table>
<thead>
<tr>
<th>in million CHF</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
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</thead>
<tbody>
<tr>
<td><strong>I. Cashflow from Investing Activities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments in R&amp;D</td>
<td>-30.00</td>
<td>-10.00</td>
<td>-10.00</td>
<td>-10.00</td>
<td>-10.00</td>
</tr>
<tr>
<td>Investments in production facilities</td>
<td>-25.00</td>
<td>-5.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments in marketing activities</td>
<td>-25.00</td>
<td>-20.00</td>
<td>-15.00</td>
<td>-10.00</td>
<td>-10.00</td>
</tr>
<tr>
<td><strong>Total Cashflow from investing activities</strong></td>
<td>-80.00</td>
<td>-35.00</td>
<td>-25.00</td>
<td>-20.00</td>
<td>-20.00</td>
</tr>
<tr>
<td><strong>II. Cashflow from Operating Activities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales Quantity</td>
<td>600,000</td>
<td>1,200,000</td>
<td>2,000,000</td>
<td>2,700,000</td>
<td>3,240,000</td>
</tr>
<tr>
<td>Sales (Average price 250 CHF)</td>
<td>150.00</td>
<td>300.00</td>
<td>500.00</td>
<td>675.00</td>
<td>810.00</td>
</tr>
<tr>
<td>Operating Cashflow (Margin 20%)</td>
<td>30.00</td>
<td>60.00</td>
<td>100.00</td>
<td>135.00</td>
<td>162.00</td>
</tr>
<tr>
<td><strong>Free Cashflow (I+II)</strong></td>
<td>-50.00</td>
<td>25.00</td>
<td>75.00</td>
<td>115.00</td>
<td>142.00</td>
</tr>
<tr>
<td>Discounted Cashflow (WACC 8%)</td>
<td>-46.30</td>
<td>21.43</td>
<td>59.54</td>
<td>84.53</td>
<td>96.64</td>
</tr>
<tr>
<td><strong>Net Present Value</strong></td>
<td>215.85</td>
<td></td>
<td></td>
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</tbody>
</table>

Assumptions

- **Average price** of 250 CHF per watch
- **Operating Cashflow margin** of 20%
- **WACC** of 8%

Smart watch division reaches a positive NPV of 215 million CHF after 5 years
Potential risks are manageable

<table>
<thead>
<tr>
<th>Risk</th>
<th>Mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Currency risks</td>
<td>Acquisition of non-swiss targets to diversify revenue</td>
</tr>
<tr>
<td>B Garmin refuses to cooperate</td>
<td>Look for different partner like Fitbit</td>
</tr>
</tbody>
</table>

Impact

Probability
Wrap-up

**Key Challenges**

1. Compete with Apple
2. Turnaround in revenue and profit

**Monday Morning Actions**

- Set up project team
- Contact partners for cooperation and investment banks

**Actions**

- Cooperate with Garmin and Google for smartwatches in sports segment
- M&A strategy in market for mechanical watches
Thank you for your attention